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Duwamish file

GREENLEAF VALUATION GROUP, INC.

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LAW OFFICES OF
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RECEIVED

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RE: **REVISED**
ARBITRATOR'S DECISION IN THE MATTER OF
THE DESIMONE TRUST/DUWAMISH MARINA PREMISES LEASE

Gentlemen:

In response to the *Memorandum of Decision* and the *Guidelines for Contract Interpretation* and the *Plaintiff's Response* to my letter of October 9, 2006, I have reviewed the entire file, including the lease itself, the arbitration memorandum, the hearing documentation and both appraisals as prepared by Anthony Gibbons, MAI, CRE for the Lessee, and by Peter Shorett, MAI, for the Lessor for the purpose of preparing this Revised Arbitrator's Decision. The following summarizes the most pertinent data reviewed and the reasoning leading to my determination of value.

PURPOSE

The purpose of this decison is to establish the June 2002 Fair Market Value of the subject property in accordance with the terms of the "1974" ground lease between the parties.

SUBJECT PROPERTY

The subject consists of three parcels, identified as tax parcels 000160-0029, -0061 and -0062, containing a gross area of 11.50 acres, which are located on the west side of the Duwamish Waterway between 93rd and 96th Streets in unincorporated King County. The land is encumbered with a long-term ground lease that began on October 11, 1974, and terminates on November 30, 2022. After commencement of the lease, the property was improved with a pleasure boat marina and associated parking on a portion of the property, with the majority of the remainder improved for container storage and repair. The improvements were completed in the later 1970s and early 1980s. Additional site work completed to date includes bank stabilization, dredging, on- and off-site utility infrastructure, fill and grading.

THE LEASE

The original lease was entered into on October 11, 1974 between the Lessor and Charles Genther as Lessee with an eight-year term with four five-year renewal options. The renewal options were to be based on the Fair Market Value of the land, exclusive of the value of the improvements placed thereon by the Lessee, provided that the lease payment be in no event less than the lease payment during the immediately preceding term. This was an absolute net lease with the Lessee responsible for all expenses. The Lessee agreed to obtain the necessary grading permits, and comply with all government regulation affecting their use of the property.

This lease was amended in April 1977 and superseded in November 1977 by a new, although substantially similar lease, with an effective date of October 11, 1974, between the Lessor and adding Szmodis, Hester and Northcoast Construction to the original Lessee, Genter, all doing business as Duwamish Marina and Industrial Park (Lessee).

In the new lease, the term was extended to November 2022, or for a total of 48 years. The lease rate to be paid was to be based on the Fair Market Value of the land, estimated at five-year intervals, again exclusive of the value of the improvements placed thereon by the Lessee, however, the lease payment was to be in no event less than the lease payment established for that portion of the term commencing December 1, 1982 ($4,792 per month based on the then current Fair Market Value of the premises, exclusive of the value of the improvements placed thereon by the Lessee, agreed to and established at $1.875 per sq ft on the gross site area or $940,000).

The lease is very specific in that the term "exclusive of the value of the improvements placed thereon by the Lessee" means in the same physical condition and original state that existed as of the commencement of the lease in October 1974, with a written description of the premises as of October 11, 1974 and a photo log of the premises taken in 1977. The estimate of Fair Market Value on which the lease rate is based is to be made as if the property was "in their size and configuration as a separate independent parcel...at its highest and best use with the zoning applicable on October 11, 1974."

ESTIMATES OF FAIR MARKET VALUE

The current proceedings are to establish the Estimate of Fair Market Value (FMV) for the five-year term commencing December 1, 2002. To this end each party has obtained an appraisal estimating Fair Market Value as of June 1, 2002. The estimates prepared by Peter Shorett, MAI for the Lessor and by Anthony Gibbons, MAI, CRE for the lessee are summarized as follows:

Appraiser	FMV	Per Sq Ft Gross Area
Shorett	$4,030,000	$8.04
Gibbons	$800,000	$1.60

The two estimates of FMV are over 500% apart, and the estimate by Gibbons is actually below the FMV value established in 1982 ($940,000 or $1.875/sq ft). Both reports have been reviewed, however the assumptions used by the appraisers are so significantly different they are essentially appraising different properties. The following briefly summarizes the significant assumptions used by each appraiser.

Factor	Shorett	Gibbons	Comment
Gross Area	11.50 acres	11.50 acres	
Uplands	10.02 acres	9.59 acres	
Submerged	1.48 acres	1.91 acres	Gibbons: Submerged not considered "usable"
"Usable"		7.83 acres	
Value Premise			
Physical	as of 1974	as of 1974	
Improvements	excluded	excluded	
H&B Use	within Zoning	within Zoning	Gibbons: Environmental regulation not included in 1974 "zoning"
Regulatory Time Period	1974	2002	
Methodology Used			
	Developmental Analysis	Direct Sales Historical Sales Developmental Analysis	
Descriptive			
Topography	Adequate soil to grade	Below grade, significant fill needed	

Soils	Adequate for development	Lack of Bearing Capacity	
Wetland/Tidelands	Natural, stream	Stream and Class II wetland, tidal channel	
Hazardous Materials	Small amounts of cement tailings, normally capped	Cement Kiln Dust, possibly hazardous, requires removal	
H&B Use			
	Industrial Use, similar to surrounding uses	Industrial Use, outside storage, single-story mfg and warehouse	Gibbons: storage rents of \$0.08 to \$0.10 per sq ft monthly can support land values that are at or above that for light warehouse and storage.

In essence, the appraisers valued significantly different properties. Shorett valued a fairly typical Duwamish waterway, South Seattle industrial property with no significant negative factors (no hazardous materials on-site, sufficient and suitable soils on-site) in the 1974 regulatory environment, while Gibbons valued a site with significant physical challenges (hazardous materials on-site, insufficient and unsuitable soils, wetland restrictions) for uses permitted under the 1974 zoning code, but impacted by 2002 environmental restrictions.

It should also be noted that in Gibbons' H& B Use analysis, his representation of storage rents implies finished land value for storage of \$12.00 to \$13.33 per sq ft at the ground lease rates of 8% to 9%.

TESTIMONY

Testimony was heard from the parties' lawyers, their appraisers, principals and various consultants. The majority of the testimony reiterated and built upon the positions, assumptions and conclusions presented in the above referenced appraisals, However, a few additional facts relevant to the determination of FMV were presented. The most significant ones are summarized as follows:

> Soil & Fill - Mel Hester indicated that while the spoils from dredging were mostly reused on site, after de-watering and testing, they were able to sell some off-site to other users. This would appear to indicate that the soils had adequate bearing capacity for reuse. Rick Powell, who appears to have done the only actual soil tests ever done on the site, on July 18, 2003,

found mostly normal Duwamish riverbed material (sand, silt sand and gravel) but did not report any layers of peat.

CKD - contrary to the representation that the CKD required removal and had been removed, Rick Powell found that the CKD had actually been capped and remains on-site. Further, while it was argued that IF the CKD were contaminated, it would require removal, no evidence was presented that it was actually contaminated. It was noted that in the few test pits dug by Rick Powell that penetrated the CKD layer, no unusual soils or obvious signs of contamination were found below the CKD layer. Irv Jones noted that CKD was actually preferred as a fill material, properly capped, as it is denser than other available fills.

OBSERVATIONS

One of the primary issues raised by the parties is whether or not the term "zoning" in 1974, as used by the parties, included environmental restrictions. The Lessor argues that environmental restrictions, if any, were part of the actual the zoning code until the early 1980s, when they began to get separated out into their own code, and that in 1974 the term "zoning" as commonly used covered all forms and types of land use restrictions. The Lessee argues that because the lease was written by smart lawyers and does not say "zoning and everything else applicable," they did not intend to restrict environmental restrictions to the 1974 restrictions.

This appears to be a novel argument not previously raised by the Lessee in prior FMV revaluations, as testimony indicated that while the first enabling legislation was enacted in the early 1970s, actual implementing ordinances did not begin to appear on the books until the late 1970s. Further, although several lawyers indicated that they would have considered environmental restrictions, actual buyers and sellers indicated that they would not have considered environmental restrictions as a separate issue in 1974.

It is apparent that this is a "hindsight" argument rather than reflecting the intent of the parties to the contract at the time of signing. Further, the lessee's appraiser's use of this argument would appear to fail to meet Daubert Standards in that this methodology is not a generally accepted methods of analysis in the profession and has not been subject to peer review and publication.

Two issue of concern are involved here, as the imposition of 2002 environmental restrictions implies both use restrictions and site development restrictions. It was testified that in 1974, the site could have been bulkheaded and filled out to the property line in a manner similar to properties to the north and south, increasing the effective upland area. It was also testified that this could not be done today.

With respect to site development restrictions, Melody McCutcheon, testified that in 2002, while the *placement* of any improvements would be restricted by current environmental concerns, the actual size and scale of any improvements would still be determined by the gross site area. In other words if the highest and best use is to build an office/warehouse with a land to building ratio of say 4 to 1, one could still build the same building, but one would have to locate the building further away from the Duwamish than would have been required in 1974.

It is apparent that both parties to the contract were very interested that only the market value of the premises be estimated and that no improvements of any kind, made by the lessee were considered. This appears to be the overall objective of the valuation sections, which provide clear and consistent directions that no improvements of any sort be considered.

It is noted that zoning is mentioned only once in the directions to the appraisers as to the initial condition of the property. The lease states that the property is to be appraised

a) in their size and condition as a separate independent parcel as of October 11, 1974
b) at its highest and best use within the zoning applicable on October 11, 1974, and
c) in its physical state as of the commencement of the lease.

It is apparent from the lease as a whole, it is concluded that the intent of the parties to the contract was to seek a current Fair Market Valuation for the subject without any change in its condition since October 11, 1974, for use in determining lease payment adjustments.

A related issue impacting the valuation is the concept of usable area. Here again the type of analysis presented by the Lessee's appraiser (valued on the basis of usable area) is not believed to have come into common practice until the late 1980s, and it was more common to value based on the gross area, with all portions of the real property having some contributory value to the whole. In the 1982 addenda to the ground lease, the unit value and rental rate quoted reflect the gross site area as the unit of measure, indicating that the parties to the contract were in agreement on the gross site area as the unit of measure.

With respect to the issue of fill and possible CKD contamination, both parties failed to persuade. The Lessor's assertion that the soils were adequate for development and that there was sufficient soil on site for grading appears excessively optimistic. It is common knowledge that river bottom lands typically require preloading and fill to provide adequate bearing capacity at a usable grade. Soils are commonly imported to accomplish this. The Lessee's argument that there was an intrinsic lack of bearing capacity is refuted by the use of the soil on-site and its sale off-site.

Similar offsetting and contradictory arguments were made with respect to the CKD issue. Based on the evidence presented, it is concluded that while there were significant amounts of uncontrolled CKD on site, the normal (and actual) practice in 1974 was to cap the material.

The issue of access and utilities as they existed in 1974 was also raised by both parties. Evidence and testimony was presented indicating the actual distance and cost of extending access and utilities to the subject. Further, the Lessee's appraiser used the actual costs as a proxy for the current distance and cost of providing access and utilities to the subject. The appraiser failed to account for the requirement that while the physical condition of the subject was to be held constant at the 1974 condition, the valuation was to reflect the impact of changes and development in the surrounding properties in 2002. It would be reasonable to assume that costs in 2002 would be significantly less due to development of the surrounding properties, bringing the connection point for access and utilities significantly closer to the subject.

In summary, the Lessee's appraiser report is deemed the less reliable of the appraisals.

ANALYSIS

As noted above, the appraisers used various methods including a Direct Sales Approach, a Historical Sales Analysis and a Developmental Analysis to value the subject. Only one method of analysis, the Developmental Analysis, was used by both appraisers.

The Lessee's appraiser presented both a Direct Sales Comparison and a Historical Sales Analysis. Normally the Direct Sale Comparison is considered the most reliable method of analysis , when the subject can be bracketed by inferior and superior comparables.

Six sales of "raw" land were presented. The unadjusted range of values was from $1.49 to $6.80 per sq ft with an average of $4.17 per sq ft. The sales occurred between September 1998 and November 2000, with a pending transaction under option from 2001 to 2003. Of the six, only two, R1 and R2, are considered reasonably comparable, the others, due to size, major site problems (rock outcropping, actual contamination, or acquisition for different Highest and Best Use) are interesting but not especially comparable to the subject. R1 and R2 show unadjusted unit value of $5.03 to $6.80 per sq ft of gross site area, and after adjustment for time reflect a range from $5.77 to $7.75 per sq ft of gross site area.

Sale R1 had kiln dust on the site, which was capped in the development of the site and appears to have required some fill, as the finished elevation is slightly above grade of the surrounding streets. Access is similar and utilities appear to have been at the property line. Most observers would consider this comparable superior to the subject.

Sale R2 was optioned at $6.80 per sq ft of gross site area about two years prior to the June 2000 sale date and subsequently sold as finished land at $12.00 per sq ft, including a build-to-suit profit. Backing out the profit on the improvements, the entitled but unimproved land value is about $9.65 per sq ft. The "option" was assigned to Roadway Express at $5.35 per sq ft. Adjusting the $6.80 per sq ft from 1998 to January 2002 at 6% annually reflects a value of $7.75 per sq ft. Again this sale would be considered superior to the subject and superior to R1.

These sales set what can be reasonably assumed to be the upper end of the likely range of value for the subject, based upon direct comparison. No sales of inferior comparable property are provided, thus the reliability of this approach is limited by the lack of adequate market data.

The Lessee's appraiser then turns his Direct Sales Comparison Analysis into the Development Analysis by deducting those cost items needed to made the site into a finished or ready to build property. Because of the appraiser's assumption with respect to 1974 environmental regulations being distinct from 1974 zoning, and his assumption that CKD removal and fill was required, he concludes to a value for the subject site at $850,000 or $1.70 per sq ft of gross site area. As testimony revealed that his assumptions were inappropriate, his conclusion via this approach is rejected.

The Lessee's appraiser also presents a Historical Sales Analysis, presenting seven sales and one ground lease that occurred between June 1972 and February 1978 with unit values ranging from $2.27 to $3.44 per sq ft with an average of $2.90 per sq ft. All the sales are described as finished land. No long-term sale and resales are shown, although the appraiser does provide a CPI index adjustment and indicates that his estimate of value as finished land in 2002 from the Developmental Analysis ($11.50 per sf usable) exceeds the CPI increase, based on his starting estimate of finished land value in November 1974 at $2.25 per sq ft.

This type of analysis is extremely sensitive to the starting point. For example, the appraiser regards the subject as lying within the $2.25 to $2.75 per sq ft range in 1974. If the high end of the range were used, the 2002 finished value would have to be $13.12 per sq ft to reflect the same price appreciation, almost doubling the appraiser's conclusion of value from this approach. Little or no reliance is place on this analysis.

Finally, the Lessee's appraiser estimates the present value of the first seven years' income stream and concludes to an "as is" land value in 1974 of $180,000, or $0.36 per sq ft. No raw land sales are provided to support this estimate of value. The lack of actual raw land sales from the 1974 period, coupled with the lack of actual demonstrated value increases, supported by sales and resales over the relevant time period, severely limits the reliability of this approach.

Overall the Lessee's Appraiser conclusions in the Direct Sale Comparison Approach were concluded to be unreliable, using methods and assumptions not commonly accepted.

The only reliable approach is the Development Approach, which both appraisers use. Between them, 16 different comparables are used to support the finished land value. The Lessor's comparables range from $9.65 to $16.96 per sq ft (average $12.31, standard deviation $2.86) while the Lessee's comparables excluding F9 at 1.79 per sq ft, range from $9.83 to $15.01 per sq ft (average $12.19, standard deviation $1.51). Four of the sales are used by both appraisers. The Lessee's appraiser concludes to a range of $11.50 per sq ft usable or $7.83 per sq ft gross, while the Lessor's appraiser concludes to a value of $10.50 per sq ft for the upland area and 33% of the upland value for the submerged land, or $9.59 per sq ft gross.

The Lessee's appraiser gives no value to the submerged or wetland areas. However, it is noted that several of his comparables have submerged or wetland areas which appear to have been given some value by the purchasers. Further, he documents in the appraisal that there are purchasers, primarily government agencies, who are primarily interested in wetlands or restorable wetlands. Finally, the parties to the contract used gross area as their unit of measure.

As a result, no credence is given to this contention, and it is concluded that the submerged and wetland area do have contributory value. As only the Lessor's appraiser provides any analysis of the contributory value of the wetland area, at 33% of the upland value, this rate will be used.

Both appraisers appear to use similar ranges of unadjusted values for the upland area, and their value range conclusions (Lessee $11.50 per sq ft, Lessor $10.50 per sq ft) overlap at $11.00 per sq ft for the upland area. This is believed reasonable and well supported by the available data.

As noted previously the two appraisals vary significantly in their estimate of the amount of work or costs that is required to bring the property up to "finished" condition. The appraisers appear to present best case vs. worst case scenarios.

Exclusive of developer's profit, the Lessee's appraiser deducts $6.39 per sq ft of gross area while the lessor's appraiser deducts $1.25 per sq ft of gross area. Both analyses fail to persuade. The Lessor's analysis lacks a reasonable analysis of fill/preload requirements and appears to make minimal cost assumptions in other areas.

The Lessee's analysis is the exact opposite, adding what appears to be excessive costs for CKD disposal and fill requirements and applying maximum cost assumptions in other areas. A typical purchaser would likely assume costs higher than those described by the Lessor's appraiser, but would anticipate being able to do better than the worst case costs presented by the Lessee's appraiser.

A second area of concern with the costs deducted by the appraisers is soft costs for engineering, taxes, overhead and contingency costs. The Lessor's appraiser applies 35% of the hard cost of development for these items but considers developer's profit to be included. The Lessee's appraiser deducts 36.9% of the hard cost for these items but then adds an additional 14% of hard cost for developers profit as a separate line item. On a comparable total development cost basis, the Lessee's appraiser's development costs are 8.2 times the Lessor's appraisers estimated development costs.

It is believed that a reasonable purchaser would anticipate hard costs to be somewhat above average to this property, buts soft costs for engineering, taxes and permits, together with contingency should be near normal. A developer's profit would also be expected to be included.

DETERMINATION OF FAIR MARKET VALUE

Based on the facts presented by the parties, the above analysis about the reliability of each Appraiser's analysis and the selection of relevant information from each report as well as my own files, together with typical market expectations about soft costs and developer's profit, the analysis on the following page summarizes my determination of Fair Market Value for the subject in its 1974 condition as of June 2002 at:

. . . .$3,150,000

It is emphasized that the above represents a brief summary of my investigation and conclusions. Thank you for this opportunity to be of service and I look forward to assisting you in the future. If you have any questions regarding this matter, please feel free to call.

Sincerely,

GREENLEAF VALUATION GROUP, INC.

James A. Greenleaf, MAI